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Project **Insurance Contracts**
Topic **Composite Margin**

Purpose of this paper

1. The Boards are considering two approaches to measuring margins in insurance contracts:
 - (a) an approach preferred by the IASB that includes the expected¹ contract net cash flows plus an explicit risk adjustment and a residual margin (see Agenda Paper 3A, FASB Memorandum 43A for a discussion of measurement issues related to risk adjustments and residual margins), a two margin model, or
 - (b) an approach preferred by the FASB that includes the expected contract net cash flows plus a composite margin, a one or single margin model. The difference between the two approaches is the risk adjustment that is explicitly included in the first approach and becomes an implicit part of the composite margin in the second approach.
2. The two approaches have certain similarities and some significant differences:
 - (a) The composite margin is initially measured as the difference between the expected value of the contract cash inflows (premiums; IASB premiums less incremental acquisition costs) less contract cash outflows (claims, benefits, and claims handling expenses). This amount is calculated to eliminate any day-one gain on the contract.
 - (b) The residual margin initial measurement also is based on eliminating a day one gain but after including an explicit risk adjustment in the contract measurement.
 - (c) The role of the composite margin (and the residual margin) in accounting for insurance contracts is sometimes characterized as a “plug” or “deferred revenue.”

¹ As used in this paper, expected cash flows are equal to the probability-weighted present value of possible net contractual cash flows. Expected cash flows can relate to cash inflows (premiums), cash outflows (claims, benefits, and related handling (settlement) expenses), or the net of the inflows and outflows.

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Both Board's have tentatively decided that there should be no gain at the inception of an insurance contract and the purpose of both the composite and residual margins is to eliminate any such gain, although the composite margin implicitly would include the risk component in that elimination.

(d) Similarly, if the initial expected contract cash outflows (including the risk adjustment for the two margin model) exceed the inflows, an onerous contract results and the Boards have tentatively decided that any net amount (loss) will be charged to expense at the inception of the contract.

3. The principal issues addressed in this paper are:

- (a) the nature of the composite margin
- (b) subsequent release of the composite margin to profit and loss
- (c) is the composite margin part of the insurance liability?
- (d) should interest be accreted on the composite margin?

4. This paper discusses how a composite margin should be released to profit or loss after inception of the contract. In developing a basis for releasing the margin, staff considers the insurer's performance under the contract in delivering protection to the policyholder. However, it also considers the risk to the insurer of the claims settlement process that begins at contract inception and lasts through the final payment on the last claim under the contract.

5. In addition to discussing the composite margin, the Boards will continue their discussion of the risk adjustment during this meeting which could, of course, change either of their current views.

6. This paper is supported by the examples in Appendix A, one illustrating the application of a composite margin approach as proposed in this paper and the other showing with a simple runoff over the coverage period of the contract and the other showing a simple nonlife contract using an unearned premium approach to accounting for implicit margins in the premium.

Staff Recommendations

7. In this paper, staff recommends for the Board's affirmation (or reaffirmation in some cases) that in accounting for the composite margin:

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- (a) if the initial measurement of an insurance contract results in a negative day-one difference, the entity should recognise that difference (loss) immediately in profit or loss. (in such a case there will be no composite margin to account for). For this purpose, a day-one loss exists if at inception the expected present value of the outflows exceeds the expected present value of the premiums.
- (b) the composite margin should be released in a systematic way. Some staff members recommend that that release should be based on the characteristics of that margin by selecting a driver (or drivers) for release that best depicts performance under the contract over a period that follows from the driver(s) for releasing that margin. Other staff members recommend that the release should be based on the insurer's exposure from providing insurance coverage as well as its exposure to uncertainties related to the future cash flows, using a combination of cash flows based on the absolute value of expected premium receipts and expected claim and benefit payments.
- (c) the allocation can be adjusted (using the same initial amount of the composite margin) over time if expectations concerning the amounts and timing of cash flows change significantly. The composite margin would be trued up based on the updated current ratio of the initial composite margin (amount) as a percentage of the total expected total cash flows over the life of the contract. That ratio applied to the cash flows to date would provide a revised amortized margin as of the reporting date.
- (d) the composite margin should be a component of the insurance liability.
- (e) an insurer should disclose the amount of the composite margin.
- (f) some staff recommend that interest be accreted on the composite margin while other staff members recommend that interest not be accreted on the composite margin.

Structure of the paper

- 8. The rest of this paper is divided into the following sections:
 - (a) Background (paragraphs 11-13)
 - (b) The composite margin (paragraphs 14-19)
 - (c) Subsequent release of the composite margin (paragraphs 20-35)
 - (d) Is composite margin part of the insurance liability? (paragraphs 36-40)
 - (e) Should interest be accreted on the composite margin (paragraphs 41-43)

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9. This paper does not discuss the impact the application of a composite margin model might have on bifurcation of embedded derivatives. We will address that when we discuss the topic of unbundling at a future meeting. Staff is also assessing whether a composite margin model has other knock-on effects compared to the application of a model with a separate risk adjustment.

10. This paper furthermore does not discuss the implicit release of margins under an unearned premium approach. The IASB has tentatively decided to require such an approach for the pre-claims period of some short term contracts, as an approximation to the approach proposed for all (other) insurance contracts. The FASB has not yet concluded on this topic.

Background

11. The Boards have decided tentatively that the measurement of an insurance contract should not result in the recognition of an accounting profit at inception. As a result, if (a) the expected present values of the premiums (IASB: premium less incremental acquisition costs) exceed (b) the expected present values of the cash outflows, that excess is accounted for as a composite margin. The composite margin would be included in the measurement of the contract at inception and then subsequently amortized (allocated) to profit and loss an appropriate period. This means this proposed insurance model is a hybrid of:

- (a) a direct liability measurement, using current estimates of expected cash flows and time value of money; and
- (b) an allocation element (the composite margin) that eliminates a day one gain and is subsequently released as income over an appropriate period.

12. The functions of the composite margin described in this paper and residual margin described in agenda paper 3A (FASB Memorandum 43A) are similar in that both result from measurements intended to eliminate day one gains. This results in certain common issues between the two margins that could result in the same or similar answers.

13. However, a major difference between the two margins is that the composite margin serves the dual functions of an implicit risk adjustment and a residual margin. This dual role likely could affect the run-off of the composite margin—especially in choosing the driver for the runoff (this is discussed in paragraphs 20-35).

Composite margins

14. The composite margin is the product of a calibration that eliminates the day one difference between (a) the expected premiums and (b) the expected claims, benefits and claims handling expenses.

15. This day one difference is a blend of elements, such as:

- (a) Under the composite margin approach, a risk adjustment is not measured separately. Therefore, the composite margin will implicitly include the price the insurer charges for risk.
- (b) Acquisition costs. The insurer will typically price the contract to recover its direct and indirect origination costs (acquisition costs) and to provide a reasonable return on the originating activity. Under the Boards' most recent tentative decisions, all acquisition costs are expensed at inception with no income reported at inception to cover those costs. However, the IASB is currently considering approaches to offset acquisition costs so that no day one losses result from the immediate expensing of acquisition costs. The FASB is exploring the merit of a recoverable for at least part of the acquisition costs based on surrender charges made by the insurer when a policyholder cancels his policy.
- (c) Differences between the retail market and wholesale market. The insurer's pricing with the policyholder is based on the retail market. However, the insurer also has access to a wholesale market, e.g., for reinsurance. Some of the insurer's inputs into the measurement of the insurance liability may be reflective of that wholesale market, which would result in the difference between pricing and measurement being included in the day one difference.
- (d) The insurer's ability to sustain higher prices than other insurers, for example in a niche market.
- (e) Insurance cycle - some insurance pricing displays a cycle of alternating 'hard' markets, when pricing is high, and 'soft' markets, when pricing is low.

16. Considering the boards' decisions in the project so far, we know that for subsequent reporting periods the composite margin:

- (a) will not be remeasured (although the staff is suggesting that it further explore reallocation of the amortization (not a remeasurement) of the margin in certain circumstances). Since the composite margin is a blend, any remeasurement after day one would lack substance and therefore the staff considers that it would not provide relevant information to users.

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(b) will not be adjusted for changes in cash flow estimates. The boards decided in their January 19 meeting that the insurer should report changes in estimates in income. Though the boards made this decision for the two margin approach, the staff see no reason for changing this for a composite margin approach. Consequently, the staff does not plan to bring this topic to the boards unless the boards determine that a separate discussion on the recognition of changes in estimates is needed for a composite margin approach.

17. The subsequent release of composite margins is therefore an allocation of the amount determined at inception, adjusted for the time value of money.

18. However, the staff does not believe there is any current prescription against a reallocation of a composite margin based on significant changes in the timing or amount of the cash flows (a cumulative catch-up adjustment with no change in the total amount of the margin per contract determined at inception).

19. Note that the composite margin, in the staff's view, cannot be negative at inception because a negative margin would indicate an onerous contract (loss) at inception and any such loss would be written off immediately.

Question for the boards

Do the boards agree that, if the initial measurement of an insurance contract results in a negative day-one difference, the insurer should recognise that difference (loss) immediately in profit or loss. (in such a case there will be no composite margin to account for). For this purpose, a day-one loss exists if at inception the expected present value of the outflows exceeds the expected present value of the premiums.

Subsequent release of the composite margin to the income statement

Basis for release

20. Since any replication of the calculation of a composite margin after day one would have no intrinsic meaning, any remeasurement would lack substance and therefore the staff considers that it would not provide relevant information to users. However, the staff believes that reallocation of the margin based on a significant change in the timing or amounts of the contractual cash flows should be used to reallocate the margin and provide useful information.

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21. The subsequent release of composite margins is an allocation of the composite margin determined at inception. It seems natural to look for a release (allocation) that best reflects the dominant characteristics of these margins. Such a basis should reflect those functions of the insurer that contribute most to its success.

22. Possible drivers for releasing the margins in a pattern that appropriately depicts performance under the contract include, but are not necessarily limited to, the following:

- (a) Release from risk
- (b) Funds under management
- (c) Expected benefit and claim payments
- (d) Premium receipts
- (e) Passage of time
- (f) A mix of two or more drivers

23. Note that item (a) could be based on either of two different notions. One is the traditional notion of bearing the risk of insured events that occur during the coverage period. The other is the period over which the insurer is exposed to the risk that the ultimate outcome may differ from the expected outcome.

24. Staff identified three possible views regarding the period over which the composite margin exists (that is, the insurer performs):

- (a) limited to the coverage period. The coverage period is the period during which the contract is in force (the period during which protection is provided). For example, the coverage period for an annual contract is one year. In most cases, the coverage period provides an easily observable time period over which to release the margin because most insurance contracts stipulate the coverage period.
- (b) the claims handling period. The claims handling period is the period from when the first claim arises to when the last claim is paid (the claims handling period often includes most if not all of the coverage period). In some instances, the coverage period and the claims handling period are not significantly different (such as for traditional life insurance). In other instances, particularly for some non-life contracts, the coverage period may be 1 year but the claims handling period can be 10 or more years.
- (c) some variation based on the coverage and claims handling periods.

25. Because risk is no longer dealt with separately under the composite margin model, it is implicit in the composite margin. Staff therefore concludes that risk should be an

important factor in determining the release of the composite margin, perhaps combined with another performance driver. Release from risk involves (i) estimating the amount of risk at inception and (ii) determining the decline of the amount of risk over time. Release from risk would be relevant for both the coverage period and the claims handling period; during both periods the insurer would be subject to uncertainty from cash flows.

26. As mentioned earlier, the composite margin approach would not determine (i) the price of risk as an implicit component of the residual margin that is not updated subsequently. However, the model should provide a method for reporting (ii) the decline or the amount of risk over time.

27. Basing the release of the margins on item (e) passage of time could provide an observable and cost-beneficial approximation for release from risk. While an assertion could be made that risk is a predominant component of the composite margin, it may not be in all instances. Therefore, releasing the margins based on the release from risk may produce results that are not a faithful representation of the economics if risk is not the predominant driver. Also, basing the release of the margins on the passage of time will not reflect uneven insurance risks, nor will it reflect changes over time in the probability that that options and guarantees may come into the money (many insurance contracts contain significant options and guarantees).

28. Some would argue that the insurer should release the composite margin to income based on the characteristics of that margin by selecting a driver for release that best depicts performance under the contract. If the contract involves a significant service element, the pattern of provision of those services is likely to be a main driver.

29. In some cases, the insurer may not be able to identify a significant service element or the service element mainly would be provided over the coverage period. In that case, some likely would argue that the composite margin should be fully released over the coverage period. In other cases, the insurer might identify significant services during the claims handling period and therefore would release some of the composite margin during that period.

30. Others could argue that release from risk should be used as a driver for reporting the composite margin to income. In that case, the period for releasing the composite

margin will be the period over which the insurer is released from risk—generally from inception to the final payment on the last claim.

31. Some could argue that using the coverage period might not reflect the fact that the performance under an insurance contract often extends well beyond that period. As a result, the claims handling period provides a more complete reflection of the obligation created by the insurance contract than the coverage period because the entity is contractually required to settle the claim regardless of the amount of time it requires making the final payment. The obligation will be settled only when the entity pays the last claim. Therefore, some believe that releasing the composite margins over the coverage period improperly accelerates the recognition of those margins.

32. Another way to determine release from risk is to adopt an approach that releases the composite margin in a systematic way that reflects (i) the insurer's exposure from providing insurance coverage and (ii) its exposure from uncertainties related to the future cash flows. For this purpose, the insurer would apply to the initial composite margin the percentage calculated by dividing the current period actual premium *plus* the current period claim and benefit cash flows divided by the expected value of the current period cash flows premiums *plus* the expected value of future claims and benefits cash flows. This would allocate a portion of the composite for the protection component (premium) of the contract as well as a portion to the risk to the insurer resulting from uncertainties related to expected claims and benefits cash flows arising from that coverage. This approach combines the cash flows related to items (c) and (d) as a measure of risk and activity into a driver that tracks with both the protection service provided by the insurer and the risk in settling claims over the claims handling period thus coverage the activity related to the contract from inception to the last payment of the final claim (likely with a greater weight to the coverage period). This arrangement could also be considered a multi-driver approach or (f) above. [See Appendix A, Case 1A for an illustration of this approach.]

33. The advantages of this approach are it is easy to understand and hopefully, by including revenue and claims, it captures the more important activities (and risks) facing the entity—both revenue and claims activity. This approach also covers the life of the contract and the allocation of the composite can be adjusted for significant changes. It seems to capture several of the features suggested for the allocation of the margin.

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However, the approach is rather mechanistic (rules based) and some would criticize the lack of a clear underlying principle..

Staff recommendation

34. Some staff members prefer an approach that would identify a main driver for performance under the contract and use that as allocation key. Often, the main driver would be release from risk, but in some cases, especially for investment products, another driver may better reflect performance under the contract. For contracts with more than one material driver, the composite margin should be allocated to those drivers at inception and then run off separately. The composite margin should be released to income over a period that follows from the driver(s) for releasing that margin.

35. Other staff members would use a combination of cash flows based on the absolute value of expected premium receipts and expected claim and benefit payments as described above. Using such a total would attach significance to risk arising from coverage (premium receipts) and risk to the insurer from settling its claim and benefit payments. Such a method can also be recalibrated for significant changes in the cash flows by revising the total cash flows (not the margin) and timing of those cash flows and computing a revised inception to date cumulative catch-up adjustment (allocation).

Question for the boards

Should the release of the composite margin released to income in a systematic way based on:

(a) the characteristics of that margin by selecting a driver or drivers for release that best depicts performance under the contract over a period that follows from the driver(s) for releasing that margin.

(b) the insurer's exposure from providing insurance coverage as well as its exposure to uncertainties related to the future cash flows, using a combination of cash flows based on the absolute value of expected premium receipts and expected claim and benefit payments.

Other issues regarding the composite margin

Is the composite margin part of the insurance liability?

36. Throughout this paper the staff discusses margins. It seems natural that margins that flow from the definition of a particular measurement approach are part of that insurance contract's liability.

37. However, the composite margin does not arise from the definition of a fulfilment notion. So its nature is debatable; is this margin part of the total insurance liability or a separate liability outside the insurance liabilities? Staff developed the measurement candidates on the rationale that these margins conceptually would be part of the overall insurance liability, but would be measured separately within the insurance liability. We have not found a rationale for recognising those margins outside the insurance liabilities.

38. Some may refer to the composite margin as an 'initial profit margin', akin to deferred income, and would recognise the day one difference as a liability, separate from the insurance liability. However, we believe that this composite margin should be regarded as part of the insurance liability for the following reasons:

- (a) The boards decided that the overall measurement of an insurance contract should at inception be calibrated to the premium (IASB: premium less incremental acquisition costs). In the staff's view this simply means that the initial measurement of an insurance contract is at transaction price (IASB: transaction price less incremental acquisition costs). In other projects where the boards recently decided that the initial measurement is equal to the transaction price, all implicit or explicit components are reported as an integral part of the carrying amount of the instrument.
- (b) it may be difficult, if not impossible, to describe this deferred item outside the insurance liability in such a way that it separately meets the definition of a liability.

39. The staff also believes the amount of the (remaining) composite margin at inception and each subsequent reporting date provides useful information that may assist the users in understanding the amounts reported and assessing the future profitability of the insurance contracts. The staff therefore recommends that the insurer should disclose the amount of the composite margin.

Staff recommendation

40. The staff recommends that the composite margin should be considered an integral part of the insurance liability—as are the cash flows. A separate classification seems to make little sense, the existence of the composite margin and role it plays in the fulfillment model (distributing profit) makes it an integral part of the accounting model and the insurance liability.

Question for the boards

Do you agree that the composite margin is part of the insurance liability rather than a separate liability outside the insurance liabilities, and that the amount of the composite margin should be disclosed?

Accreting interest on the composite margin

41. This issue addresses whether interest should be accreted on the composite margin. Recall that the composite margin is itself the difference between two discounted amounts (expected cash flows in and out). In addition, the staff believes that the composite margin is an integral component of the insurance liability (see paragraphs 36-40 above), which, according to the building blocks is a discounted amount.

42. The Boards have tentatively decided that the measurement of insurance contract liabilities should incorporate time value of money. Some may therefore recommend accreting interest to a composite margin, also considering that it may be of significant size and/or may be released over many periods, accreting interest to that margin can have a material impact. Others point out that interest is generally accreted on cash flows but not on deferred profits (which is a noncash item). In their view the composite margin simply represents the difference between two balances and does not reflect any specific component of the contract but rather an amalgamation of components that are not separately identified.

Staff recommendation

43. Some staff members recommend that interest be accreted on the composite margin, consistent with the treatment of other components of the insurance liability—both at inception and at each period end when the expected cash flows are updated and discounted. Other staff members recommend that interest should not be accreted on the composite

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margin because it is a noncash item and, in the view of those staff members, accreting interest on it provides no additional benefit for the additional cost.

Question for the boards

Do the boards believe that interest should be accreted on the composite margin?

Overview

1. This Appendix includes two simple short-duration (property and liability) examples (Cases) based on a prospective model that uses explicit building blocks. The presentation in the performance statement of Case 1A is based on a ‘premiums and claims’ approach and in Case 1 the presentation of the performance statement is based on margins. The main purpose of the examples is to support the discussion in this paper about the subsequent release of a composite margin.
2. The examples are highly simplified and use only a few basic assumptions to keep the Cases understandable and allow the reader to focus on a few key points in each Case. Since the same Base Case 1A is the foundation for both cases, comparisons of the impact of alternatives is facilitated. Although Case 1 is new, these cases are from a series of cases presented to the Boards last fall.
3. Although a prospective building block approach is used in Case 1, Case 1A is similar to those that would result from an unearned premium approach adopted by the IASB as a requirement for short-duration contracts and soon to be discussed by the FASB. Since various components of the summary balance sheet and the income statement are detailed in the examples, the format can easily be used for constructing various scenario and presentation formats. The income statement presentation in this example is a summarised margin approach.

Background

4. The assumptions for each of the Cases are listed at the top of each Case. The insurance contract used in the examples is a standard annual auto contract—more specifically, 5,000 auto contracts each with an annual premium of CU1,000, all written at the beginning of the year. The assumptions used are intended to demonstrate the accounting issues related to the contracts—they are not intended to be representative of actual contracts or the results of a book of business. In other words, the information used is hypothetical, although the staff believes it is not unrepresentative of a group of insurance contracts. For simplicity, the examples do not include the effects of inflation and the use of discounting for insurance liabilities. The periods covered in each case

are the two halves of the first year and the subsequent four years (to allow time for the complete runoff of what is assumed to be a short-tail book of business).

The Cases

5. Case 1 shows the use of the building blocks (no discounting for simplicity in creating the insurance contract liability at inception). The Performance Statement shows the runoff of the contract for five years. The composite margin is amortized over the coverage and claims handling period based on the total absolute amount of the contract cash flows over the life of the contract as discussed in this paper. That is each period's cash flows would be a percentage of the total cash flows which would then be applied to the composite margin to determine the margin amortized for each period.

6. Case 1A is a Base Case, a straight forward short-duration insurance example. The similarity between the revenue recognition and the unearned premium approach is readily apparent. Simply substitute the words unearned premium for performance obligation in Case 1 and the transition is nearly complete—both terms refer to accounting elements that represent customer consideration and both are stand-ready obligations that would operate in a similar fashion for many short-duration nonlife insurance contracts.

Nonlife Insurance Examples	Expected at						
	Inception	1H	2H	Yr 2	Yr3	Yr 4	Yr 5
Case 1 - FAS 60: Short-duration contract accounting with Composite Margin							
Assumptions							
Contracts	5,000						
Premium per contract per year (paid quarterly)	1,000						
Total premium	5,000,000	2,500,000	2,500,000				
Claims Accrual - Ratio to Premiums Earned (4Qs)	4,000,000	80.0%	80.0%				
Claims Payments		15.0%	25.0%	20.0%	15.0%	15.0%	10.0%
Margin - Ratio to Premiums Earned	1,000,000	20.0%	20.0%				
Total (=Performance Obligation)	5,000,000						
Total cash flow=premiums (expected cash inflow) + claims payments (expected cash outflow)		5,600,000	1,000,000	800,000	600,000	600,000	400,000
Cummulative cash flow		9,000,000	3,400,000	2,400,000	1,600,000	1,000,000	400,000
Margin amortization = remaining marginx (current period cash flow/(current period cash flow+expected future total cash flow))		1,000,000	377,778	266,667	177,778	111,111	44,444
		622,222	111,111	88,889	66,667	66,667	44,444
Case 1 - FAS 60: Short-duration contract accounting with Composite Margin							
	<u>Inception</u>	<u>1H</u>	<u>2H</u>	<u>Yr 2</u>	<u>Yr3</u>	<u>Yr 4</u>	<u>Yr 5</u>
Assets							
Cash - bop		5,000,000	4,400,000	3,400,000	2,600,000	2,000,000	1,400,000
Check for claims		(600,000)	(1,000,000)	(800,000)	(600,000)	(600,000)	(400,000)
Cash - eop		4,400,000	3,400,000	2,600,000	2,000,000	1,400,000	1,000,000
Total Assets	-	4,400,000	3,400,000	2,600,000	2,000,000	1,400,000	1,000,000
Liabilities							
Contract Rights and Obligations							
Contract Rights (Premium Payment by Customer at Inception) - Cash	(5,000,000)						
Performance Obligation (same as FAS 60 Unearned Premium, a Stand-Ready (Pre-claim) Obligation)	5,000,000						
Net Contract Balance	-						
Claims Liability (Incurred Claims) bop	4,000,000	4,000,000	3,400,000	2,400,000	1,600,000	1,000,000	400,000
Claims expense - accrual							
Claims cash payments		(600,000)	(1,000,000)	(800,000)	(600,000)	(600,000)	(400,000)
Claims liability eop		3,400,000	2,400,000	1,600,000	1,000,000	400,000	-
Margin	1,000,000	377,778	266,667	177,778	111,111	44,444	-
Total Liabilities	5,000,000	3,777,778	2,400,000	1,600,000	1,000,000	400,000	-
Retained Earnings		622,222	733,333	822,222	888,889	955,556	1,000,000
Total Liabilities and Retained Earnings	5,000,000	4,400,000	3,133,333	2,422,222	1,888,889	1,355,556	1,000,000
Performance Obligation - Expected Composition (Not Explicit)							
Expected Future Claims Cash Flows	4,000,000	2,000,000	-	-	-	-	-
Composite Margin	1,000,000	-	-	-	-	-	-
Total Performance Obligation	5,000,000	2,500,000	-	-	-	-	-
Income Statement							
	X-Check Totals						
Claims expense - expected	4,000,000	-	-	-	-	-	-
Claims expense- actual	(4,000,000)	-	-	-	-	-	-
Release of Composite Margin	1,000,000	622,222	111,111	88,889	66,667	66,667	44,444
Profit	1,000,000	622,222	111,111	88,889	66,667	66,667	44,444

Nonlife Insurance Examples		<u>Expected at</u>						
	<u>Inception</u>	<u>1H</u>	<u>2H</u>	<u>Yr 2</u>	<u>Yr3</u>	<u>Yr 4</u>	<u>Yr 5</u>	
Case 1A - FAS 60: Traditional short-duration contract accounting Assumptions								
Contracts	5,000							
Premium per contract per year (paid quarterly)	1,000							
Total premium	5,000,000	2,500,000	2,500,000					
Claims Accrual - Ratio to Premiums Earned (4Qs)	4,000,000	80.0%	80.0%					
Claims Payments		15.0%	25.0%	20.0%	15.0%	15.0%	10.0%	
Margin - Ratio to Premiums Earned	1,000,000	20.0%	20.0%					
Total (=Performance Obligation)	5,000,000							
Case 1A - FAS 60: Traditional short-duration contract accounting								
	<u>Inception</u>	<u>1H</u>	<u>2H</u>	<u>Yr 2</u>	<u>Yr3</u>	<u>Yr 4</u>	<u>Yr 5</u>	
<u>Assets</u>								
Cash - bop		5,000,000	4,400,000	3,400,000	2,600,000	2,000,000	1,400,000	
Check for claims		(600,000)	(1,000,000)	(800,000)	(600,000)	(600,000)	(400,000)	
Cash - eop		4,400,000	3,400,000	2,600,000	2,000,000	1,400,000	1,000,000	
Total Assets	-	4,400,000	3,400,000	2,600,000	2,000,000	1,400,000	1,000,000	
<u>Liabilities</u>								
Contract Rights and Obligations								
Contract Rights (Premium Payment by Customer at Inception) - Cash	(5,000,000)							
Performance Obligation (same as FAS 60 Unearned Premium, a Stand-Ready (Pre-claim) Obligation)	5,000,000							
Net Contract Balance	-		-					
Claims Liability (Incurred Claims) bop	4,000,000	2,000,000	2,000,000					
Claims cash payments	(4,000,000)	(600,000)	(1,000,000)	(800,000)	(600,000)	(600,000)	(400,000)	
Claims liability eop		1,400,000	2,400,000	1,600,000	1,000,000	400,000	-	
Total Liabilities		1,400,000	2,400,000	1,600,000	1,000,000	400,000	-	
Retained Earnings		500,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	
Total Liabilities and Retained Earnings		1,900,000	3,400,000	2,600,000	2,000,000	1,400,000	1,000,000	
<u>Performance Obligation - Expected Composition (Not Explicit)</u>								
Expected Future Claims Cash Flows	4,000,000	2,000,000	-	-	-	-	-	
Composite Margin	1,000,000	-	-	-	-	-	-	
Total Performance Obligation	5,000,000	2,500,000	-	-	-	-	-	
<u>Income Statement</u>								
	X-Check Totals							
Premiums	5,000,000	2,500,000	2,500,000	-	-	-	-	
Claims Expense	(4,000,000)	(2,000,000)	(2,000,000)	-	-	-	-	
Release of Composite Margin								
Profit	1,000,000	500,000	500,000	-	-	-	-	